



USAID'S LEADERSHIP IN PUBLIC FINANCIAL MANAGEMENT

Detailed Guidelines for Improved Tax Administration in Latin America and the Caribbean

Chapter 16. Internal Audit

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Detailed Guidelines for Improved Tax Administration in Latin America and the Caribbean

Chapter 16. Internal Audit

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List of Acronyms and Abbreviations

Acronym	Definition
CAAT	Computer assisted audit techniques
CIAT	Inter-American Center of Tax Administrations
CPE	Continuing professional education
IIA	Institute of Internal Auditors
INTOSAI	International Organization of Supreme Audit Institutions
IRS	Internal Revenue Service of the United States
IT	Information technology
LAC	Latin America and the Caribbean
OLACEF	Organization of Latin American and Caribbean Supreme Audit Institutions

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Chapter 16. Internal Audit

The purpose of this chapter is to define "internal audit" and to discuss the very important role that the staff of this organizational component play in tax administration. The term "internal audit" refers to the process of conducting periodic reviews to ensure that selected regulations, operations, administrative procedures and programs, and internal controls of the tax administration conform to specified standards and are being implemented efficiently and effectively. Internal audits include the review and appraisal of policies, practices, systems, and procedures as well as the analysis and verification of accounts, financial transactions, internal controls, and reports.

The following aspects of internal audit are addressed in this chapter:

- The primary mission of internal audit and the very important role its staff play in the tax administration;
- The scope of authority that needs to be formally given to the internal audit function for its staff to accomplish their mission and to operate effectively and efficiently;
- Staff qualifications and training;
- The importance of information technology (IT) in internal audit activities;
- A typical organizational chart and the responsibilities of the various organizational units;
- Necessary inter-relationships between internal audit and the internal control function, that investigates alleged corruption and integrity issues among tax administration staff; and
- Operating policies and procedures of the internal audit function.

16.1. Leading Practice

The mission of internal audit is to promote public confidence in the tax administration by providing the public and management with independent, timely, and professional periodic reviews that:

- Promote economic, efficient, and effective administration of the country's tax laws;
- Detect and deter waste, fraud, corruption, and abuse in tax administration programs and operations; and
- Inform the head of the tax administration of significant risks or deviations from defined laws, regulations, policies, and objectives throughout the organization.

All modern tax administrations have internal audit staff, who conduct independent and professional internal audits on behalf of the Director General to ensure that responsibility at all organizational levels is effectively and efficiently discharged and in accordance with laws and regulations. In carrying out their official duties, internal audit staff must have the full cooperation of tax administration officials at all levels as well as full, free, and unrestricted access to review the tax administration's activities, reports, records, and property. To eliminate any doubt about the authority of the internal audit function, language to the latter effect – preferably statutory, through regulations, or by formal delegation - must be made a part of the official record.

The internal audit function can be, and often is, part of a division in the tax administration's functional structure that also includes the integrity investigations function¹, although these two functions are somewhat different. Whereas internal audit focuses on the quality and efficiency of tax administration systems, procedures, and processes, integrity investigations focus on allegations of corruption and misconduct by tax officials. Integrity investigation staff conduct professional and timely investigations of such misconduct and then recommend sanctions against those officials in confirmed cases. In collaboration and cooperation with the Director of Integrity Investigations, the Director of Internal Audit is also responsible for advising the Director General about the status of the integrity of tax administration personnel. Both functions are also jointly charged with designing programs to identify and apprehend employees or non-employees that are corrupt or are attempting to corrupt employees of the tax administration.

Despite differences between the two functions, their staff must work together closely. In some cases, internal auditors engaged in their routine activities uncover suspected integrity irregularities, which they refer to the Director of Integrity Investigations for further action. In such cases, integrity investigators and internal auditors usually work together to further develop cases by applying their respective knowledge and skills. On suspected integrity cases initially developed by internal investigators, assistance from internal auditors is sometimes required and requested to further develop aspects of cases that are in the realm of internal auditors' knowledge and skills.

The integration of internal audit with integrity investigations in a functional organization structure at headquarters and at regional organizations has been successful in many countries. In the United States for example, the Internal Revenue Service's (IRS) Integrity Investigations and Internal Audit divisions, each with a Division Head, operated very effectively for many years under the Head of a central organization called the "Office of Chief Inspector," whose top official reported directly to the Commissioner of the IRS. At each of the seven regional office locations in the United States, Assistant Regional Commissioners for Inspection supported the respective Regional Commissioners with internal audit reviews and integrity investigations at district/field offices under the jurisdiction of each Regional Commissioner. However, the Assistant Regional Commissioners for Inspection reported directly to the Chief Inspector in the national headquarters, but not to the Regional Commissioners, as an added precaution to maintain their independence.

Internal audit activities should conform to the standards and guidelines established by a recognized organization in the field of internal audit. The Institute of Internal Auditors (IIA) is the recognized international standard setting body for internal audit. The IIA is an associated member of the International Organization of Supreme Audit Institutions (INTOSAI), which itself is a worldwide affiliation of governmental entities, primarily an umbrella organization for external government audit. As of 2011, its members included the Chief Financial Controller/Comptroller General/Auditor General Offices of nations, with a total of 191 national-institution members. Many countries have also issued standards for the conduct of governmental audits, such as the United States Comptroller General and the Auditor General of Canada.

¹ Tax administration integrity is discussed in Chapter 17.

16.1.1. Differences between Management and Internal Audit Oversight

According to leading international practice, the establishment of financial standards and internal controls is normally the responsibility of management and not of internal auditors. This is so, to ensure that the assets of the organization are properly protected and reflected in the records, that the debts (or liabilities) of the organization are properly reflected, that the organization is operating in an efficient and effective manner, and that the results of operations are properly presented. Managers at each level of the tax administration are required to perform compliance oversight and reviews of progress on objectives in all functions within their own management responsibilities, which are supplemented with periodic reviews by functional analysts (audit, collections, etc.) in the regional and/or headquarters office.

Internal audit, on the other hand, provides higher management with an independent review and assessment of operations, programs, systems development, and financial activities. All internal audit reviews are conducted through planned testing of available data, including statistical sampling techniques, rather than a complete review of transactions. Operations and program reviews assess:

- Whether program objectives are appropriate;
- The extent to which the objectives of the programs are still relevant to the tax administration's mission;
- The effectiveness of management's reviews of internal controls;
- The adequacy of management's system for measuring effectiveness;
- The extent to which a program achieves a desired level of accomplishment;
- The effectiveness of the program or individual program components;
- Factors that inhibit satisfactory performance;
- Whether management has considered alternatives that may yield desired results more effectively or at lower costs; and
- Whether the program compliments, duplicates, overlaps, or conflicts with related programs.

During system reviews, internal audit staff determine whether the design, development, and installation of new automated information systems or applications provide a reasonable assurance that systems and applications:

- Carry out the policies prescribed by management;
- Provide the controls and audit trails needed for management operational reviews;
- Include controls necessary to protect against loss or serious error;
- Are efficient and economical in operations by detecting and deterring inefficiency and waste;
- Conform to legal requirements; and
- Are documented in a manner that will provide the understanding of the system required for maintenance and auditing.

Financial reviews are conducted to allow internal auditors to verify the accuracy and adequacy of financial statements and other reports of financial operations. These reviews provide internal and external users with an independent opinion on whether the reports fairly present the results of financial operations.

In effect, internal audit is a fact-finding function and, as such, has no direct responsibility for, or authority over, employees engaged in tax administration operations. The Director of Internal Audit transmits reports that present the facts developed in the internal audit activities to management officials who are charged with taking appropriate corrective action. Findings are also always reported to the Director General, who is charged with reviewing and appraising all of the tax administration's activities and actions, or the lack of appropriate action.

16.1.2. Qualifications and Training for Internal Auditors

All internal auditors recruited by tax administrations should have a university degree in accounting. After recruitment, internal auditors should have classroom and on-the-job training to prepare them to perform the following tasks:

- Reporting identified problems, and the related causes, to various levels of management and recommending possible solutions or corrective actions; and
- Gathering, organizing, and analyzing facts on financial transactions to determine compliance with relevant regulations, including any financial administration and audit acts of their country, the applicable auditing standards, and the tax administration's rules governing all financial transactions.

Among the topics that should be covered in classroom training courses for internal auditors are:

- Revenue administration;
- Revenue laws and regulations;
- Accounting and accounting systems;
- Internal audit standards and audit techniques;
- Computer fraud;
- Computers as an investigative tool;
- Computer assisted audit techniques;
- Organizational structure and functions of each of the tax administration's departments;
- National finance, administrative, and audit acts;
- Investigative and interviewing techniques; and
- Investigative report writing.

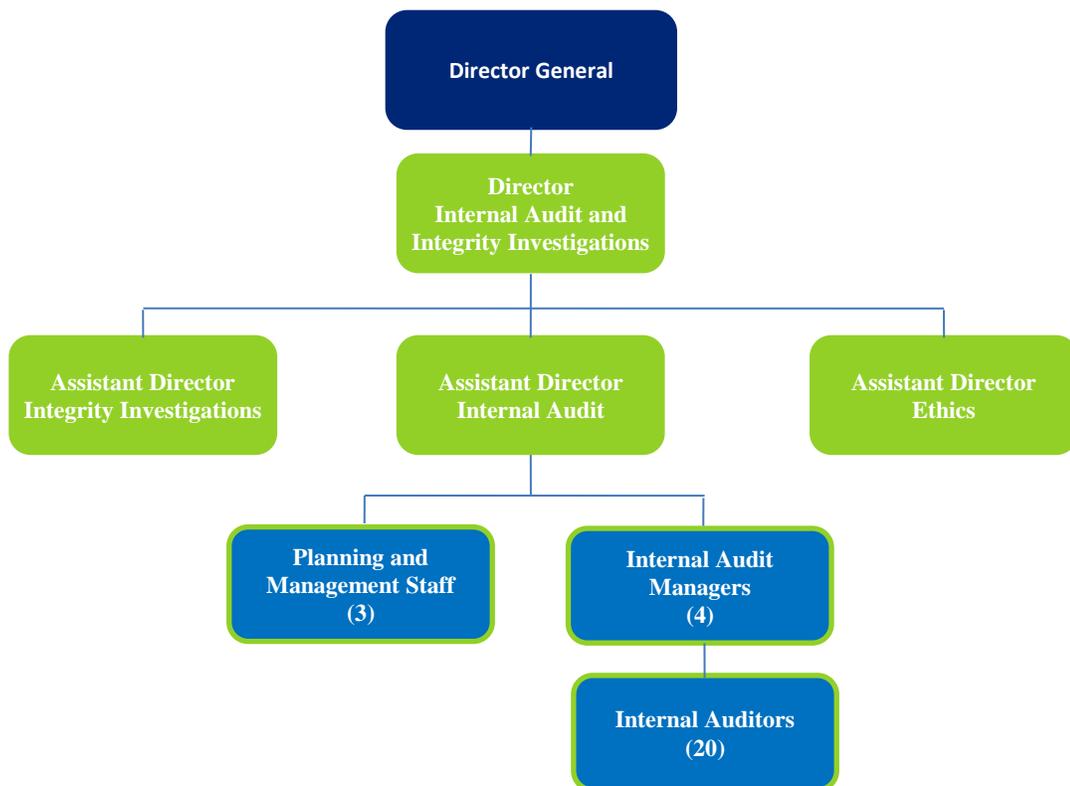
The important classroom and on-the-job training program goals are to enable the internal auditor to:

- Conduct complex managerial and financial auditing and special assignments to assess program efficiency, desired objectives, and compliance with program laws, regulations, and other provisions;
- Review and report on matters, such as breakdowns in internal controls and, particularly, the coordination, direction, execution, and accomplishment of the tax administration’s programs;
- Prepare internal audit memoranda and draft audit reports on complex functions, systems, or on one or more broad functional areas, in conformance with accepted writing and reporting standards;
- Communicate with appropriate officials at various levels of management on uncovered problems, causes, recommended changes, and the evaluation of subsequent corrective actions; and
- Develop and conduct special in-depth examinations of activities within general guidelines or in high risk programs where employees of the tax administration could commit fraud.

16.1.3. Typical Organizational Structure and Components²

The internal audit department’s typical organizational structure is shown below and includes the integrity investigations and ethics components, which are addressed in Chapter 17.

Figure 16.1. Organizational structure of an internal audit department



² Appendices 4.A and 4.B of Chapter 4 show the typical functional organizational structure of the headquarters of large and medium or small tax administrations respectively. Note that the Director of Internal Audit and Integrity Investigations reports directly to the Director General.

The numbers below the titles of each component of the internal audit division are suggested numbers of accountants and internal auditors, including managers, for small tax administrations with fewer than 5,000 total employees. Medium and large tax administrations should increase staff proportionately. The suggested, small span of control of five internal auditors per manager applies to a tax administration with a fairly new internal audit function. Ten internal auditors per manager is an effective and efficient span of control in an experienced internal audit department. The long-term staffing of internal audit should be established based on studies made to determine the universe of organizations, programs, activities, and functions subject to internal audit. This list should then be consolidated and refined into a list of auditable (or assessable) areas. Once these auditable areas are determined, and decisions on the frequency of audits for these areas are made, it is possible to determine the number of staff required to produce a balanced internal audit program.

The responsibilities of the staff in each of the main components of internal audit are listed below. The details provided can serve as an input for drafting new or amending current job descriptions.

16.1.4. Responsibilities of the Assistant Director of Internal Audit

The main responsibilities of the Assistant Director of Internal Audit are to:

- Serve as the principal advisor on internal audit matters to the Director of Internal Audit and Integrity Investigations and to the Director General;
- Carry out line and functional responsibility for conducting a program of an independent review and appraisal of the operations of all tax administration departments;
- Conduct reviews that provide information on the condition of all functional activities and are sufficient in scope to provide a basis for constructive management action by officials responsible for the activities involved;
- Be responsible for a systematic verification and analysis of financial transactions;
- Review and appraise the protective measures and controls established at all operating levels;
- Supervise the organizational structure for internal audit program operations, including management staff and audit groups;
- Be responsible for the development and execution of the internal audit annual program; and
- Coordinate with the central government's Auditor General, other internal audit governmental institutions, and professional internal audit organizations at national and international levels.

16.1.5. Responsibilities of the Planning and Management Staff

The main responsibilities of the Planning and Management Staff are to:

- Recommend improvements, new procedures, and audit techniques for improving the overall quality of internal audit programs;
- Control, coordinate, and develop the internal audit annual work plan;
- Control, coordinate, and develop the internal audit inputs to the tax administration's strategic plans;

- Identify significant developments, problems, trends, and management initiatives that should receive the attention of the internal audit department and keep abreast of current IT developments so that proper consideration can be given in the development of IT applications to support the internal audit program;
- Conduct research and special studies to ensure that the most efficient and effective computer audit techniques are utilized in carrying out all facets of the internal audit program;
- Develop systems and programs to utilize computerized techniques in carrying out principal segments of the internal audit program;
- Ensure that audit retrieval systems are designed and provided on new or upgraded IT systems, so that internal audit staff can perform audits of these systems;
- Formulate and maintain internal audit policies, procedures, and program guidelines, including manuals and internal audit handbook instructions, and develop and coordinate the training and staff development program for all internal audit staff;
- Control and maintain the internal audit management information system;
- Prepare recurring and periodic reports on the department's programs and accomplishments; and
- Be responsible for the quality control and review of all internal audit reports.

16.1.6. Responsibilities of Internal Audit Managers

The main responsibilities of internal audit managers are to:

- Conduct internal audits of activities and programs in all of the tax administration departments;
- Plan and conduct comprehensive reviews of high impact areas of special interest to the Director General and other top-level officials of the tax administration;
- Conduct special assignments in cooperation with the staff of integrity investigations on cases requiring the specialized knowledge and training of internal audit personnel;
- Plan, control, manage, execute, and report on activities for which internal audit has control responsibility;
- Conduct special surveys, examinations, and projects and coordinate, evaluate, review, and follow through on audit findings;
- Bring significant audit disclosures to the attention of top management of the various departments of the tax administration;
- Conduct reviews of major IT system development projects;
- Help operating managers develop new or improved IT systems by reviewing management proposals and designing specifications to ensure that the IT systems and applications carry out the policies prescribed by management;
- Provide internal controls and audit trails needed for the management and audit of the IT systems;
- Provide effective and cost-efficient controls to protect against theft and serious error;
- Ensure that reviews provide confirmation that IT systems and applications conform to legal requirements and are clearly documented; and

- Participate in the development of long-term and annual internal audit plans and help prepare special purpose audit programs and guidelines.

16.1.7. Main Responsibilities of Internal Auditors

The main responsibilities of all internal auditors are to:

- Develop and implement audit programs designed to evaluate the efficiency and economy with which financial and functional operations are conducted;
- Undertake a constant review of the tax administration's financial accounting operations and systems with a view to detecting and, where possible, preventing errors and fraud;
- Ensure that the tax administration's accounting records are accurate, complete, and up to date through the design and implementation of proper systems of internal checks;
- Ensure the effectiveness and adequacy of control systems, procedures, and records by undertaking regular checks of these areas of the tax administration's operations to detect waste and idle capacity in the use of resources;
- Evaluate the effectiveness of certain policies and procedures in safeguarding the tax administration's assets against defalcation, loss, or waste and, where necessary, recommend appropriate changes to current policies and procedures;
- Report to the Director General any significant deficiencies observed, and provide an opinion as to the adequacy of current policies and procedures; and
- Continuously undertake spot checks of the accounting system procedures and records of the tax administration to ensure that they are:
 - Accurate, complete, and up to date; and
 - In accordance with the provisions of national financial laws and regulations.

16.1.8. Operating Procedures

An annual internal audit work plan is developed and completed two to three months before the start of each calendar or fiscal year. The plan contains the allocation of resources to all activities, such as specific audits and training, and set objectives and responsibilities among the internal audit staff. The planning methodology for internal audit involves three interrelated managerial processes of: 1) deciding how to use organizational resources; 2) interpreting and reporting on what is actually happening in the tax administration; and 3) taking actions in response to this information. Internal audit should develop a universe of organizations, programs, activities, and functions subject to audit and produce an inventory of assessable units that will be utilized to plan organizational resource utilization and to develop budget requests that are specific to the units to be audited.

The planning and execution of the internal audit annual work plan each year should be in conformance with the following:

- Priorities are established to ensure that assessable areas are subject to audit based on risk factors, with each area reviewed on a scheduled basis;

- Audit procedures and guidelines are established to ensure that audit planning and execution are properly accomplished;
- Benchmarks are established to assess the efficiency and effectiveness of audits;
- Audit standards are established, based on IIA/INTOSAI or similar standards; and
- Reporting procedures are established and monitored to ensure that management properly addresses findings and recommendations.

Internal audit findings are usually presented in written reports that contain factual presentations of the auditors' findings. Non-integrity issues found during routine internal audit activities should first be reported in draft to the top functional management official directly charged with appropriate corrective action, such as the head of the audit or collections division. After discussions with the affected official and his staff lead to an agreement on the facts in the internal audit report, the findings are provided to the district/field office director with a request that the Assistant Director of Internal Audit be advised by the district/field office director in writing, by a given deadline, of the corrective actions to be taken (note that the internal audit report may include suggested corrective actions). A copy of the findings is provided to the Director General. Internal audit can and should make sample, follow-up audits to ensure that the corrective actions are, in fact, being implemented. Major issues or areas of disagreement between the internal audit officials and district/field office officials that cannot be resolved at the proper level of authority are referred to the Director General for resolution.

After the completion of an audit (except on internal audits where integrity is an issue), it is extremely important that policies and procedures always require the internal auditors involved to present draft reports and preliminary findings to affected officials, so that they have an opportunity to agree with the facts presented or provide information to correct any errors. In tax administrations that disregard such policies and practices, staff at all levels of the organization's line and support components tend to view the internal audit reviews of any and all aspects of their operations as "intrusive," and it is common for internal auditors to be viewed by operations staffs as "the enemy." In fact, in this type of organizational climate, those being reviewed can find ways to "thwart" the effectiveness of internal audit reviews to some extent. Therefore, top management of the tax administration, particularly the Director General, the Director of Internal Audit and Integrity Investigations, the Assistant Director of Internal Audit, and top-level functional managers must establish a culture of mutual respect, collaboration, and cooperation between auditors and those who are audited.

The Assistant Director of Internal Audit should prepare an annual report, in addition to any statutory required periodic reports, for the Director of Internal Audit and Integrity Investigations and for the Director General summarizing the audits conducted, the corrective actions taken, and other significant accomplishments. This report should also contain an assessment of the strengths and weaknesses in the systems and controls of the tax administration and recommendations that have been made to overcome weaknesses.

16.2. Common Trends

Internal audit in tax administration has evolved from the task of financial auditing. In addition, advances in technology, changes in risk management, and systems and organizational issues have been changing the roles of internal audit, as discussed below.

16.2.1. Use of Information Technology

In recent years, like other functions of the tax administration, internal audit has embraced the trend for more and better computerization and IT, including many corresponding modern tools, such as:

- A centralized repository of all audit plans, work papers, audit work programs, findings, reports, and follow-up;
- Comprehensive audit plan management throughout the life cycle of each audit, including resource assignments and work plan creation;
- Automatic generation of audit work papers directly from work plans;
- Audit task management with fully automated and customizable workflow;
- Graphical reporting of audit activities, status updates, and results;
- Documentation of recommendations, management responses, and oversight of remediation projects;
- Sophisticated capabilities for creating, managing, and analyzing customizable surveys for any size organization; and
- Enhancement of risk management programs, including:
 - Annual risk assessments;
 - Configurable scoring and prioritization;
 - Streamlined set-up and execution of assessment questionnaires with reusable questions, response sets, and question templates; and
 - Documentation of control tests.

Information technology has transformed the operations of tax administrations all over the world. As internal audit expands its role from financial and regulatory compliance reviews to audits, assessments, and inspections of operations, systems, and quality of ever more computerized components of the tax administration, it too must advance technologically. There is a trend to upgrade the technology infrastructure used to carry out audits – from risk assessments and creating the audit universe, to planning, to audit data collection and reporting. Internal audit components in some modern tax administrations are migrating from their legacy systems and paper-based procedures to web-based, integrated audit management systems.

16.2.2. From Oversight to Strategy

The role and value of the internal audit function in tax administration have evolved over the years from that of oversight to that of strategy, based on the following recent trends.

Evolving Role and Expanding Scope of Internal Audits

Traditionally, financial auditing, controls, and regulatory compliance were the primary focus areas that governed internal audit activities. In recent years, the role of internal audit has expanded to include the assessment of operations, programs, system development, and integrity investigations, in addition to financial auditing and regulatory compliance. More recently, internal audit staff have been involved in reviews and recommendations that focus on business process optimization, streamlining of operations, managing risk, prioritizing goals and activities, eliminating complexity and redundancy, and driving down costs.

Tax Administration Performance and Quality Assessments

Internal audit has been helping to strengthen the organization and management of tax administrations' departments by reviewing and analyzing the efficiency and effectiveness of operations, in addition to conducting quality assurance activities. There is now recognition that internal audit, by reviewing operations and recommending improvements, can guide the redeployment of resources to more revenue productive programs and even contribute to increased revenue collection. Similarly, the implementation of internal audit recommendations has resulted in improved cost-effectiveness of tax administration operations. Furthermore, there is growing recognition that the public's impressions of tax administration operations improve with the knowledge that internal audit staff are conducting reviews of operations and practices, independently from operations staff.

Greater Collaboration with Operations Officials

In the past, in many countries, too many operating officials at all levels viewed internal audit as "the enemy" that was "not to be trusted." Consequently, there was reluctance to share information with internal audit staff. Operations officials in many countries even made it a standard practice to withhold pertinent information from internal auditors. Today's business environment and the expanding role of internal audit call for greater collaboration and stronger relationships between internal audit and operations officials at all levels of the tax administration. The trend, therefore, is moving towards an organizational culture that encourages a free flow of information regarding any issues or concerns between the two parties in a way that fosters mutual respect and facilitates accountability. It should be noted, however, that internal audit must continue to maintain its independence by having a direct reporting line to the Director General.

Shift towards Risk-Based Auditing

Similarly to using computerized mathematical formulae to automatically select those taxpayers for audit that pose the highest risk to revenues, internal audit has begun to identify and prioritize assessable areas based on the greatest risk factors to the tax administration in the internal audit annual work plans. For example, the highest risk for revenue loss to the tax administration is from the country's large taxpayers. Therefore, internal audit reviews in the large taxpayer program must rank very high in the internal audit's work plans. Similarly, Internal audit must also give very high priority to ongoing reviews of major system developments and their implementation because of the very high risk of rapid, negative

impact on the entire tax administration, should major errors or deviations not be timely detected and corrected. Data security is also an ongoing challenge for tax administrations all over the world. Therefore, there is a trend for internal audit, along with the entire tax administration, to address all risk, compliance, and governance issues related to data security.

Computer Assisted Audit Techniques

Computer assisted audit techniques (CAAT) are becoming much more necessary to automate and streamline internal audit processes and to alleviate the burden on internal audit staff, who are often tasked with a wide variety and number of reviews on a less than fully automated basis. CAATs enable real-time, automated testing of critical data of the tax administration and greatly increase the efficiency of internal audit staff. In short, technology enables the audit process and allows for risk assessments to be performed automatically, continually, and without any substantial recurring efforts. However, such technology improvements require significant initial investment, as well as training.

Recruitment and Retention of Internal Auditors

Changes in the audit landscape require internal auditors to have a broad range of skills and so the profession is very challenging. Coupled with persistent cuts in governmental budgets worldwide and opportunities for higher compensation in the private sector for internal auditors, it is more and more difficult to find new and retain experienced staff and to maintain continuity in internal audit operations of tax administrations. Therefore, it is incumbent on Directors General and Directors of Internal Audit and Integrity Investigations to be aggressive in policies and practices to recruit and retain good staff. Such policies and practices would include: only recruiting and selecting fully qualified, professional personnel; providing successively challenging training courses for internal auditors and rotating their assignments; developing and administering a meaningful performance evaluation system; and providing prompt recognition and rewards for above average performance.

16.3. Tax Administration Maturity

Four maturity levels of tax administrations with respect to internal audit are described below. Of course, a specific tax administration may find that it fits the characteristics of several of the levels below. In this case, the tax administration may be in transition from one maturity level to another.

Internal Audit: Maturity Level 1

Key word: "Not present"

- There is no internal audit function in the tax administration.
- Internal audits, mostly of financial controls, in all government institutions, including the tax administration, are the responsibility of the central government's Office of Auditor General.
- Internal audits by the Office of Auditor General of any aspect or activity of the tax administration are minimal and occur only once or twice every four to five years for many reasons, including severe understaffing of the Office of Auditor General.

- When performed, internal audits are perfunctory, lack depth, and have little significance, in part because internal auditors of the Office of Auditor General have very little knowledge and understanding of the workings of the tax administration.
- The Director General has little or no knowledge of whether the tax administration conforms to any independent standards of financial and accounting controls.

Internal Audit: Maturity Level 2

Key word: "Aware"

- After recognition by officials of the Ministry of Finance and the tax administration of the need to manage their own internal controls, a small internal audit unit was established, perhaps less than five years ago, under the Director General. However, there is no statutory language, regulation, or delegation of authority to formalize the internal audit role and the authority of its staff.
- Internal auditors have not had classroom training specifically designed for internal audit. Some are not well qualified and do not have university degrees in accounting, and many have little knowledge and understanding of the tax administration's various business processes, revenue laws, and regulations.
- Policy and procedures manuals and handbooks for internal auditors have not been developed.
- There is no planning and management staff (or similar planning unit) in the internal audit organizational structure. The internal audit top official and some of his or her staff develop an ad hoc work plan each year with no input from any other part of the tax administration. Activities in the work plan focus mainly on financial and accounting controls, with little work on assessment of operations, programs, quality assurance, systems, systems development, and risk management.
- There is no knowledge or adherence in the work plans to the standards of the IIA/INTOSAI or other internal audit organizations' standards.
- There is no clear policy or understanding of the differences between operational reviews by management officials and internal audit reviews. Internal audit staff sometimes attempt to order functional staff to take remedial actions on internal audit "findings" not yet corroborated by management. Disagreements about internal audit "findings" are common and usually have to be resolved at the Director General level.
- Relationships between internal audit staff and the staff of most other components of the tax administration are antagonistic.
- The annual contributions of internal audit to the overall efficiency and effectiveness of the tax administration are minimal.

Internal Audit: Maturity Level 3

Key word: "Taking shape"

- An internal audit unit was established, perhaps between five and nine years ago and its role and authority in the tax administration are defined by statutory language, regulation, or delegation.
- Most internal auditors in the unit have university accounting degrees and most have had classroom training specifically designed for internal auditors, but the course has not been updated in recent years to include computer-assisted internal auditing tools and techniques. There are few opportunities for continuing professional education (CPE) for long-time internal auditors. Staff attrition is relatively high, mainly because the private sector offers much higher compensation.
- Policy and procedures manuals and handbooks have been developed and are available in hard copy, but are usually not kept up to date.
- Internal audit recently established a universe of organizations, programs, activities, and functions subject to audit and produced an inventory of assessable units that has been utilized to plan organizational resource utilization and to develop budget requests that are specific as to assessable units to be audited.
- The internal audit planning and management staff (or similar staff) prepares an annual work plan each year that takes into account the "universe of auditable areas" and input from other top-level functional officials. Activities in the work plan include some audits on internal accounting controls and financial and functional operations, as well as assessments of operations, programs, systems, and systems development. The internal audit unit is beginning to design audits to manage high-level risks to the tax administration.
- IT infrastructure, equipment, and budgets for CAATs are very helpful, but somewhat limited.
- Internal audit activities are completely conducted based on planned testing of available data, including statistical sampling techniques, rather than a complete review of transactions, under the standards set by a regional institution of internal audit which adheres to the standards of the IIA/INTOSAI.
- The fact-finding role of internal audit is mutually understood by internal audit and management officials. Findings of internal audit reviews are usually handled accordingly, with disagreements resolved and management concurrence obtained before findings are finalized and submitted to the Director General.
- The relationships between internal audit staff and the staff of most other components of the tax administration are good, and the internal audit unit is generally viewed as "effective and fair".
- Internal Audit generally meets the performance benchmarks listed below in Section 16.5.

Internal Audit: Maturity Level 4

Key word: "Strategic player"

- An internal audit unit, with its role and authority in the tax administration defined by statutory language, regulation, or delegation, has been part of the tax administration for ten or more years.
- All internal auditors in the unit have university accounting degrees and have had classroom training specifically designed for internal auditors, which is updated every two to three years

and includes the latest CAATs. All experienced internal auditors are given opportunities and compensation to attend CPE courses in local universities. Internal audit staff are highly motivated and attrition is low.

- Policy and procedure manuals and handbooks are promptly updated and are available electronically to all internal auditors.
- The universe of organizations, programs, activities, and functions subject to audit for the last few years is subject to focused reviews and recommendations on business-process optimization, the streamlining of operations, managing risk, prioritizing goals and activities, eliminating complexity and redundancy, and driving down costs.
- The internal audit planning and management staff (or similar staff) prepares annual work plans, with input from other top-level functional officials. In addition to activities related to business process optimization, the work plan also focuses on more and higher priority involvement with audits designed to manage high-level risks to the tax administration.
- IT infrastructure, equipment, and budgets for CAATs are adequate and very helpful.
- Internal audit activities are conducted based on samples, under the standards set by a regional institution of internal audit which adheres to the standards of the IIA/INTOSAI.
- The fact-finding role of internal audit is mutually understood by internal audit and management officials. Findings of internal audit reviews are usually handled accordingly, with disagreements resolved and management concurrence obtained before findings are finalized and submitted to the Director General.
- The relationships between internal audit staff and the staff of most other components of the tax administration are excellent, and the internal audit unit is generally considered a strategic partner.
- Internal Audit invariably meets or exceeds the performance benchmarks listed below in Section 16.5.

16.4. Latin America and the Caribbean

With very heavy reliance on external audits for many years, formal internal audit units as organizational entities within tax administrations are relatively new in most Latin American and Caribbean (LAC) countries. Most LAC tax administrations have internal control organization entities,³ but there is also a very low number of sanctions and disciplinary actions for infractions, indicating that internal controls are "more a formality than truly effective."⁴ A few LAC countries are squarely in the 3rd level of maturity (Chile, Colombia, Argentina, Brazil, Mexico and a few others), but a majority lies between the 2nd and 3rd levels of maturity. The following mix of features of the 2nd and 3rd maturity levels is representative of the situation in most LAC countries.

- After relying mainly on external audits by the central government for many years, internal audit units have been established within the tax administration, and statutory language, regulation, or

³ Inter-American Center of Tax Administrations (CIAT) et al. (2012), p. 12.

⁴ Ibid., p. 71.

delegation of authority to formalize internal audit's role and the authority of its staff exist, but generally lack clarity;

- Some internal auditors have not had classroom training specifically designed for internal auditors, and some newer auditors have little knowledge and understanding of the tax administration's various business processes, revenue laws, and regulations. Attrition is relatively high, with experienced internal auditors often seeking better opportunities and higher compensation in the private sector;
- Policy and procedures manuals and handbooks for internal auditors have only recently been developed, but hard copies are not usually kept up to date;
- The internal audit planning and management staff (or similar planning unit) prepares a work plan each year, but there is limited or no input from any other part of the tax administration. Activities in the annual work plan focus on financial and accounting controls, and the internal audit unit is only just beginning to assess operations, programs, quality assurance, systems, systems development, and risk management;
- IT infrastructure, equipment, and budgets for CAATs are extremely limited;
- Internal audit's work adheres to the standards of the Organization of Latin American and Caribbean Supreme Audit Institutions (OLACEF);
- The differences between operational reviews by management officials and internal audit reviews are understood; however, inexperienced members of internal audit's staff occasionally attempt to direct functional staff to take remedial actions on internal audit findings that have not yet been corroborated by management. Disagreements about internal audit findings occasionally have to be resolved at the Director General level;
- Relationships between internal audit staff and the staff of most other components of the tax administration are fair at best, with frequent internal audit staff/operations staff disagreements about Internal Audit findings, which have to be resolved by the Director General;
- Internal audit each year meets some, but not all, of the performance benchmarks listed below in Section 16.5; and
- Waste, fraud, and abuse in the tax administration are decreasing each year, but are still not under manageable control.

It should be noted that external control audit institutions of governments and their audits of financial controls and other activities of tax administrations (and of other government agencies) have a long history in LAC countries. The existence of OLACEF, its periodic regional conferences, working groups, and library of documents is a strong source of support and opportunity for LAC countries as they endeavor to improve their internal audit organizations and activities. In fact, OLACEF, established in 1965 and associated with INTOSAI, abides by the international standards of external government audits.

Membership in CIAT is also source of strength of LAC countries. As members, LAC countries can seek opportunities to get assistance from and collaboration with the Inter-American Center of Tax Administrations (CIAT), which also has and makes available to all its members, a wide array of studies,

documents, and publications about internal audit and internal controls. In fact, CIAT published an Internal Audit Manual in 2006⁵, which is available to all members.

Perhaps the biggest threat to the internal audit function in LAC countries is the general and persistent inadequacy of financial resources in tax administrations' budgets to upgrade IT infrastructure and facilitate the use of CAATs by internal auditors. Without such modernization and scarce human resources, it is very difficult for internal audit units to expand their assessments of operations, programs, systems, systems development, business process optimization, and audits designed to manage high-level risks to the tax administration.

16.5. Key Benchmarks and Guidelines

The most important benchmark for internal audit is that its work adheres to internationally accepted or leading practice standards, such as those of IIA/INTOSAI. In addition, once the number of staff is determined, the key indicators of performance for the internal audit function each year are:

- 90 percent of routine audits are initiated within 15 days of assignment, and the other 10 percent are initiated within 30 days.
- 60 percent of total available time of internal auditors is spent on direct operations, while 40 percent is spent on training, administrative matters, and personal time.
- In 90 percent of cases, the average number of calendar days to complete is within ± 5 percent of the scheduled time.
- In 95 percent of cases, draft reports of findings are issued for management response within 15 days of completion of the audit, and within 25 days for the other 5 percent.
- In 90 percent of cases, reports are completed and submitted to the Director General within 30 days of receipt of managements' responses, and within 45 days for the other 10 percent.
- In 95 percent of cases, the results of quality reviews of audit work papers and reports by internal audit management are positive.

⁵ Inter-American Center of Tax Administrations (CIAT) (2006), *CIAT Internal Audit Manual*. (http://www.ciat.org/biblioteca/opac_css/index.php?lvl=notice_display&id=821)

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